

FILED

IN THE UNITED STATES DISTRICT COURT  
FOR THE NORTHERN DISTRICT OF ALABAMA

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SOUTHERN DIVISION

U.S. DISTRICT COURT  
N.D. OF ALABAMA

UNITED STATES OF AMERICA

v.

CATHY EDWARDS

CR-03-C-0183-S

RULE 11(f) FACTUAL BASIS FOR GUILTY PLEA

**COMES NOW** the United States of America through its undersigned counsel, for the purpose of satisfying the requirements of Federal Rule of Criminal Procedure 11(f), submits the following Factual Basis in support of the guilty plea of **CATHY EDWARDS**:

HealthSouth

1. *HealthSouth Corporation* ("*HealthSouth*") was formed in 1984. *HealthSouth* is the nations largest provider of outpatient surgery, diagnostic imaging and rehabilitative health care services with over a thousand locations in all 50 state and abroad. Since around 1998, *HealthSouth*'s common stock has been listed on the New York Stock Exchange. Many of its executives, including its Chief Executive Officer ("CEO"), either owned shares in *HealthSouth*, or owned options to such shares. The CEO, and others, were also compensated in part by bonuses. The bonuses depended on how well *HealthSouth* performed financially.

3. *HealthSouth*, like other companies whose shares were publically traded, generated and publicized earnings expectations. Stock market analysts did the same. Whether a company met, exceeded, or failed to meet such expectations, was often a factor the influenced the price of its shares.

4. Since in or about 1986, when it made its Initial Public Offering (IPO), *HealthSouth* has been an issuer of a class of securities registered under Section 12 of the Securities Exchange Act of 1934, required to file quarterly and annual statements (Forms 10-Q and Forms 10K) under said Act with the Securities Exchange Commission ("SEC"). These statements reported *HealthSouth*'s earnings, as well as the value of its assets and liabilities.



These reports were available to the public, which used them to determine whether *HealthSouth* met the aforesaid expectations.

5. Under provisions of the federal securities laws and the regulations promulgated thereunder, *HealthSouth* was also required to make and keep books, records, and accounts that accurately and fairly reflected the transactions and dispositions of the company's assets; and to devise and maintain a system of internal accounting controls sufficient to provide – (i) reasonable assurances that the company's transactions were recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles ("GAAP") and other criteria applicable to such statements and to maintain the accountability of assets; and (ii) reasonable assurances that the recorded accountability for assets was compared with the existing assets at reasonable intervals and appropriate action was taken with respect to any differences.

#### The Conspiracy.

6. Beginning before 1994, the CEO and senior management at *HealthSouth*, including William Owns, Weston Smith, and Emery Harris, conspired to inflate the financial statements filed with the SEC, at least some of which were electronically transmitted from the Northern District of Alabama to Washington, D.C., to defraud investors and *HealthSouth*, and to make false entries in *HealthSouth's* books, records, and accounts.

7. Owens, Smith, Harris, *HealthSouth's* CEO and others reviewed monthly and quarterly preliminary reports showing *HealthSouth's* true and actual financial results, which usually showed that *HealthSouth* had not met earnings per share expectations. These persons would then direct that *HealthSouth's* accounting staff manipulate *HealthSouth's* books, accounts and records to ensure that *HealthSouth's* earnings per share number met or exceeded those expectations.

8. Methods to increase earnings included making entries to reduce offsets against revenues or to reduce expenses. Corresponding fraudulent entries were made to increase assets and decrease liabilities on *HealthSouth's* Balance Sheet. Such entries were made in *HealthSouth's* (1) Property, Plant and Equipment ("PP&E") accounts; (2) cash accounts; (3) inventory accounts; and (4) intangible asset (goodwill) accounts, among others.

9. These entries caused the quarterly and annual financial statements filed with the SEC for the years from before 1994 through 2002, that is, Forms 10-Q and Forms 10K, to be materially false. The cumulative inflations summed to over one billion dollars. Some of these statements were transmitted electronically from Alabama to Washington, D.C., to be filed with the SEC.

10. The CEO and other conspirators benefitted from the conspiracy by receiving salaries, bonuses, and an increased value in their stock and stock options. The investing public suffered to the extent they paid for shares whose value was inflated by the aforesaid conspiracy.

#### The Defendant

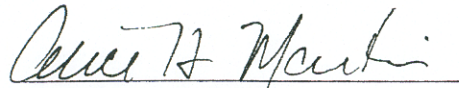
11. Defendant Edwards was first employed by *HealthSouth* as a temporary employee in mid 1993 in the accounting department responsible for fixed assets. She had a degree in education but no accounting experience. Later in 1993, she became permanently employed. In 1995, she became a supervisor. In 1999, she became an Assistant Vice President. In 2001, she became a Vice President. She reported to senior managers who were involved in the aforesaid scheme.

12. In 1999, her supervisors, including Owens and Harris, told her that debits would be "temporarily parked" in some of her asset accounts. She noticed that this actually happened. Later, senior managers asked her to make the entries herself. They told her that this was temporary. This became a regular practice, however, and "temporary" became permanent. She was never supplied with the usual back up documentation for the debits. The amounts being "parked" were large amounts, sometimes close to \$80 million a quarter, but were broken up and allocated to numerous accounts. She came to understand that the debits were bogus and designed to inflate the financial statements of *HealthSouth*. She nevertheless, continued to make the entries as instructed by Harris and others up to around June of 2002. Even then, the previous inflation of the accounts, for the most part, were not backed out of the accounts. She also came to understand that the inaccurate information in her accounts would be and were reflected in financial statements submitted by *HealthSouth* to the SEC. She also helped to conceal the practice from auditors by changing descriptor codes in the accounts, and by falsifying invoices to show that assets had been acquired by facilities the auditors were spot checking, when in fact the



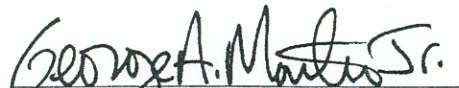
invoices were for assets acquired by other facilities.

13. On or about November 13, 2001, *HealthSouth's* Form 10-Q for the third quarter of 2001, which contained materially false and inflated values, was transmitted by wire in interstate commerce, that is, from Birmingham, Alabama to Washington, D.C., for filing with the SEC.



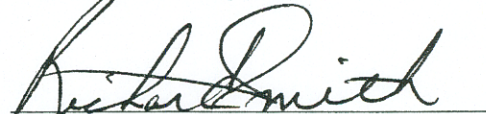
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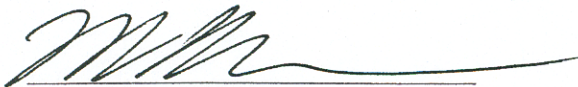


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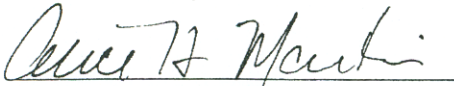
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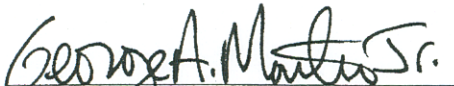
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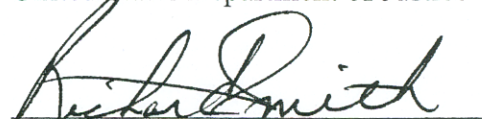
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